HISTORY OF BANK INDONESIA : MONETARY
Period from 1966-1983

Contents :

		Page
1.	Highlights	2
2.	Focus Of Policies 1966-1983	4
3.	Strategic Steps 1966-1983	5
4.	Foreign Exchange Policies in Indonesia 1966-1983	6
5.	Exchange Rate Policies in Indonesia 1966-1983	7
6.	Foreign Debt Policies 1966-1983	8

1. Highlights

From 1960-1965, the Indonesian economy had to cope with extremely heavy burden as a result of the Government's policies which were focused on political interests. The guided economic doctrines had virtually drained up nearly all the Indonesian economic resources to finance the government's political projects. It was not that surprising that this period experienced extremely low GDP growth, exceptionally high inflation rate that reached 635% in 1966 and flagging investment. In implementing monetary policies, Bank Indonesia was burdened with Multiple Objectives, namely maintaining the rupiah stability and playing the role of the circulation bank which disbursed loan advance to the Government, extended liquidity loans and direct loans to state institutions and the businessmen.

Initially in 1959, the government adopted the tight money policy in a bid to cope with the inflationary pressure. This policy was implemented by, among others, issuing the credit ceiling for all banks on individual case on April 8, 1959. In addition, the government announced the monetary sanitation move on 25 August 1959 by lowering the value of fractions of Rp500 and Rp1,000 to respectively Rp50 and Rp100, and froze current account deposits and time deposit as much as 90% for the value exceeding Rp25,000 and turned into long-term saving. The efforts to curb inflation went on until early 1960s by way of restricting the bank loans both quantitatively and qualitatively.

On 25 August 1959, the Government devaluated the rupiah exchange rate as much as 74.7% from Rp 11.40 against USD to Rp 45 against US. However, such rupiah devaluation was not applicable to calculation of taxable earnings and revenues and nor taxes. Subsequently, the Government determined the export-import duties linked with the rupiah value. Such provision obligated the exporters to pass on the export levies amounting to 20% from the sales price, while the importers were obligated to pay import levies to the Government in the amount of 0-200% depending on the types of imported goods.

During the first half of 1960s, the Government's expenditures were soaring, particularly to finance the government's projects which raised the inflationary impact towards the state coffer. To respond to this, on 13 December 1965, the government emitted new rupiah banknotes of which their value was compressed. The denomination of Rp 1,000 was squeezed to Rp1 of the new banknote. Furthermore, to defend the foreign exchange reserve which continued to slide throughout this period, the government controlled the foreign exchange sources, namely the traffic of the trading, earning and spending of foreign exchange in the sector of services and capital supervision to prevent capital flight.

During the period of the Guided Democracy, the Indonesian foreign policies were in favor of the East Block. Indonesia's closeness to China and Russia strained

Indonesia's relationship with the West. Worse, under the pretext of the revolutionary and self-reliance spirit, on 17 August 1965, the government decided to withdraw from IMF, the World Bank and the United Nations. Upon such withdrawal, the plans to repay the debts over the Outstanding Drawing according to the agreed schedule were replaced with the Settlement of Account agreement. Indonesia's outstanding to IMF amounting to USD 61.9 million surged to USD 63.5 million including interest would be repaid through 10 installments of every 6 months as from 17 February 1966. The economic condition that became uncontrollable under the Guided Economy made the government prohibit BI from issuing its Annual Report and Monetary Statistics. The ban was aimed at maintaining the country's economic stability.

2. Focus Of Policies 1966-1983

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The change of regime in 1996 from the Old Order to the New Order had as a significant impact to the economic development in Indonesia. Basically, the economic development during this period was focused on two aspects, namely improving the conditions inherited by the former regime and stabilization to improve the people's welfare as mandated by the State Major Guidelines.

The economic mess inherited from the previous government was among others, hyperinflation, damaged economic infrastructure, moral degradation of the civil servants due to rampant corruption and poverty.

This hyperinflation was mainly a result of two major factors, namely deficit spending policy and short supply of goods, particularly foodstuff.

As a result, the economic policies, including the monetary policies were intended to cope with the above issues.

3. Strategic Steps 1966-1983

To ease hyperinflation, the Government issued monetary policies concerning the supply side, namely increasing the banks' Minimum Mandatory Current Account (GWM) up to 30%, raising bank interest rate (for loans and time deposit), imposing the expansion ceiling of bank net assets and banning of long-term bank lending and import credit, particularly for consumption goods.

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In addition, the Government revamped the supply side in a consolidated manner involving several Ministries whereby the banking sector was assigned to extend subsidized credit, in particular to ensure enough supply of foodstuff and clothing.

To improve the people's standard of living, the monetary policies introduced were focused on stimulating the people's economy. This was done through the development of business undertakings by the economically weak community members, through subsidized bank lending and entrepreneurship enhancement programs.

In respect to the foreign exchange, the policies adopted were aimed to develop export commodities by amending the exchange rate policy and made it more realistic and attractive for the exporters, as well as amending the foreign exchange policy from the controlled to semi-controlled one. This was done by easing the foreign exchange flow brought in by foreign investors.

The other policies pertaining to the monetary policies were among others developing the private sector through the public saving drive, developing the people's economy and cooperatives, intensification and expansion of economic potentials by way of transmigration and food stabilization policy through the establishment of the Logistic Agency (BULOG).

Until the end of 1969, the inflation was lowered and reached 9%???. Further monetary policies were aimed at supporting the long-term development programs, respectively lasting for 5 years. Their priority scales were regulated in the Major State Guidelines.

4. Foreign Exchange Policies in Indonesia 1966-1983

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As a consequence, through Government Regulation No. 64 of 1970 which replaced Act No. 32 of 1964, the Government relaxed its foreign exchange control and welcome foreign capital. This policy aimed to smoothen the export activities and foreign exchange traffic. This Government Policy introduced two types of foreign exchange, namely General Foreign Exchange (DU) and Credit Foreign Exchange (DK). General Foreign Exchange was earned from trade of goods and services, while Credit Foreign Exchange was earned from overseas aids, namely foreign loans and grants.

Bank Indonesia was assigned to control the foreign exchange traffic. Meanwhile, the Government also set up the National Export Development Institution (LPEN) to boost export. LPEN's duties were among others disseminating information to the government institutions, exporters and buyers overseas.

Such semi-controlled foreign exchange policy remained being enforced until 1982. Furthermore, Indonesia embraced free foreign exchange policy pursuant to Government Regulation No. 1 of 1982. This Government Regulation stated that each citizen could freely use foreign exchange without exerting any obligation to report it, unlike in other countries.

5. Exchange Rate Policies in Indonesia 1966-1983

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This multiple exchange rate system was revoked on 17 April 1971 and replaced with the sole exchange rate system offering conversion rate of Rp 378 against US dollar.

This exchange rate was later devaluated to Rp 415 against US dollar on 23 August 1971. Rupiah was further devaluated on 15 November 1978 to Rp 625 against US dollar. This move simultaneously revised the exchange rate system from US dollar peg only to the conversion against a basket of foreign currencies of the main trading partner countries.

As a result of this policy change, rupiah exchange rate was drawn closer to different markets and was expected to stimulate export more. At the end of this period, namely on 30 March 1983, the government announced another rupiah devaluation to Rp 970 against US dollar.

6. Foreign Debt Policies 1966-1983

During this period, the controlled foreign exchange regime remained being enforced and even more strictly. This was evident from the policy of collecting the export earnings and import ban of certain commodities.

In the beginning of this period, the Government started to adopt a balanced state budget relying on the foreign loans as the source of its standby funds. Also, the Government attempted to obtain a consent from the donor countries to reschedule its old foreign borrowings secured by the former regime, from both western block and eastern block countries. In addition, the government endeavored to obtain fresh loans to finance its development programs. In this way, the government did not rely on the central bank's funding alone.

The government initiated these rescheduling efforts through the Paris club forum in which the Dutch government acted as the host. This meeting was focused on obtaining a consent from the donor countries to reschedule the Government's old loans. Following a series of meetings, the Paris Club gathering in April 1970 agreed to a solution to settle the old borrowings, namely the principle loans be payable for 30 years from 1970 to 1999 through annual installments, while the interest be paid through 15 installments as from 1981. The principle borrowings be settled for 30 years with the same annual installment amounts. The first installment be made in 1970, while the payable interests be settled through annual installments in the same amounts. The interest installment payment began from 1985.

To revive the economic activities, in February 1967 a meeting was convened in Amsterdam to discuss the borrowing needs, which would be used as the supplementary funding source to finance the development programs under soft prerequisites. The meeting managed to set up Inter Governmental Group on Indonesia (IGGI). This was an informal body as it lacked any official incorporation deed nor permanent secretariat. This body did not have other institutional instruments either which truly reflected its official status. This forum was therefore an international institution without any obligation or pressure to its members. IGGI was simply a forum to ensure coordinated efforts for its members as the medium to share information and opinions.